GLAECONOMICS

The impact of revenue centralisation on London's economic growth

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Context

Compared to other OECD countries, the UK remains one of the most fiscally centralised countries. This centralisation curtails London's ability to raise its own revenue to administer and fund local economic and social plans.

GLA Economics conducted a modelling exercise to assess the extent to which this centralisation of revenue-generating powers could have undermined London's growth between 2010 and 2019.

Key Points

- The UK is one of the most fiscally centralised OECD countries, with less than 6% of total tax revenue raised locally as of 2021[1].
  - By comparison, the 38 OECD member-states raised just under 11% of their tax revenue locally (on average).

- According to the ONS[2], between 2010 and 2019, London's GVA grew by 2.39% annually (on average) after adjusting for inflation[3].
  - Comparable cities within OECD countries that have a unitary system of governance (i.e., just like the UK's), and that enjoy greater fiscal devolution, grew by 2.56% during that same decade on average.
  - If we include comparable cities within OECD countries irrespective of system of governance (federal, regional, or unitary) and that enjoy greater fiscal devolution, the average annual growth rate is 2.54%.

- If London's annual real GVA growth between 2010 and 2019 matched the average for comparable OECD cities in unitary states with greater devolution of revenue generation, then London would have generated at least an additional £38bn in GVA over the last decade.
  - This translates into just under an extra £460 per Londoner per year.

- If London's annual real GVA growth matched the average of comparable OECD cities irrespective of governance structure, then London would have generated an additional £34bn in GVA over the last decade;

[1] Brochure: Revenue Statistics 2023: Tax Revenue Buoyancy in OECD Countries
[2] Regional economic activity by gross domestic product, UK - Office for National Statistics (ons.gov.uk)
[3] Inflation adjustment was done using data on CPI inflation from the World Bank.

  - This translates into an extra £400 per Londoner per year.

- Meanwhile, comparable cities within OECD countries that have a unitary system like the UK's but that enjoyed either the same or less fiscal devolution grew by 2.33% annually during that same decade (on average). If we include comparable OECD-country cities irrespective of governance structure, that rate drops to 2.08%.

Background Information

- Existing studies on the impact of devolution on economic growth provide inconclusive results, with some pointing to positive impacts while others could not determine any effect[4].

- Another study by GLA Economics for the London Finance Commission concluded that the type of decentralisation determines whether it positively affects growth or not. If tax revenue is decentralised (i.e., fiscal devolution), then that would boost economic growth (other things equal)[5].
  - However, if expenditure is decentralised (i.e., the local government is delegated greater spending powers), then that form of devolution may not necessarily enhance growth.

- The UK remains one of the OECD's most centralised countries when it comes to fiscal policy and revenue generation.
  - For example, in 2021, less than 6% of the country's total tax revenue is generated at the local level according to the OECD[6]. While, on average, an OECD member-state raised just under 11% of its total tax revenue locally in that same year.

Overview of Modelling Exercise

- With that in mind, comparing London's economic growth performance to that of similar cities[7] (by Gross Domestic Product (GDP)) in OECD countries that devolve more of their fiscal powers to local government could indicate whether revenue centralisation could have hindered the city's growth over time. GLA Economics decided to model two counterfactual scenarios:

  - **ONE**: comparing London's annual real GDP growth to the average growth for cities in OECD member-states that also have a unitary style of governance[8] (i.e., where central government is the overarching authority), but devolve more revenue-generating powers to local government.

  - **TWO**: comparing London's annual real GDP growth to the average growth for cities in OECD countries that devolve more revenue-generating powers to local government irrespective of whether they have a unitary, federal, or regional governance structure.

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[4] GLA Economics (2022). Devolution and economic growth in London - a rapid evidence review | London City Hall
[5] Wingham (2017). Available at: devolution-and-economic-growth-wp84.pdf (london.gov.uk)
[6] **Note**: Although less than 6% of total revenue is generated locally in the UK on average, London is expected to have a slightly bigger % due to additional money-raising options available to the Mayor. That said, it would be a slight and inconsequential difference. A similar case could also apply to other cities in the analysis.
[7] **Note**: Henceforth, 'cities' refers exclusively to the largest economic city in an OECD country (i.e., the city with the largest GDP). Hence, they are similar to London in terms of their economic weight relative to their respective country's gross domestic product.
[8] OECD member-states fall in 3 categories: unitary (e.g., UK, Portugal), federal (e.g., the United States, Canada, and Australia), and regional (e.g., Spain and Colombia). See Appendix.

- The first scenario allows us to not only control for the level of political and economic development in these cities (i.e., the OECD being a club of "rich, developed countries"), but it also allows us to compare London to cities in countries that have the same structure of political governance. This would exclude countries with federal and regional structures since they are more likely to devolve fiscal powers to their local authorities due to their system.

- The second scenario tests whether devolving revenue-generating powers to local authorities could lead to greater economic growth for London irrespective of structure of political governance.

Methodology

- The analysis covers the decade from 2010 to 2019, thereby excluding the effects of the COVID-19 pandemic, the UK-EU post-Brexit Trade and Cooperation Agreement, and other significant geopolitical and economic events outside this timeframe (and which would undoubtedly impact on growth at the national and local levels across the 38 OECD member-states).

- The sample included the largest cities by economic size in 34 OECD member-states plus London.

    - The largest cities in Costa Rica and Israel (San José and Tel Aviv respectively) were not included as no data on their GDPs going back to 2010 was found.

    - Dublin (Ireland) was also excluded as its GDP (and Ireland's in general) is distorted significantly by profit shifting due to Ireland's corporate taxation system. This means that GDP would substantially overstate Dublin's domestic production and income[9].

- Looking at the OECD's 2019 Revenue Statistics[10], there were 23 OECD countries that devolved more revenue-generating powers locally. Four of them were federal countries, two were regional, and 17 had a unitary governance structure (just like the UK).

SCENARIO 1: Comparing London to the largest cities in OECD countries with unitary structures that devolve more revenue generation locally

- For the 17 countries that have unitary structures, the cities with the largest GDPs (i.e., the largest cities economically) were selected for the comparison with London; they are the 'comparator cities'.

- For these cities, their GDPs (in current prices) for the years 2010-2019 were collected from three sources: their countries' statistical agencies, their central banks, or Eurostat (for cities in EU member-states).

- These current-price GDPs were adjusted for inflation using Consumer Price Index data for the 17 countries (collected from the World Bank), before determining the average real GDP growth for each city.

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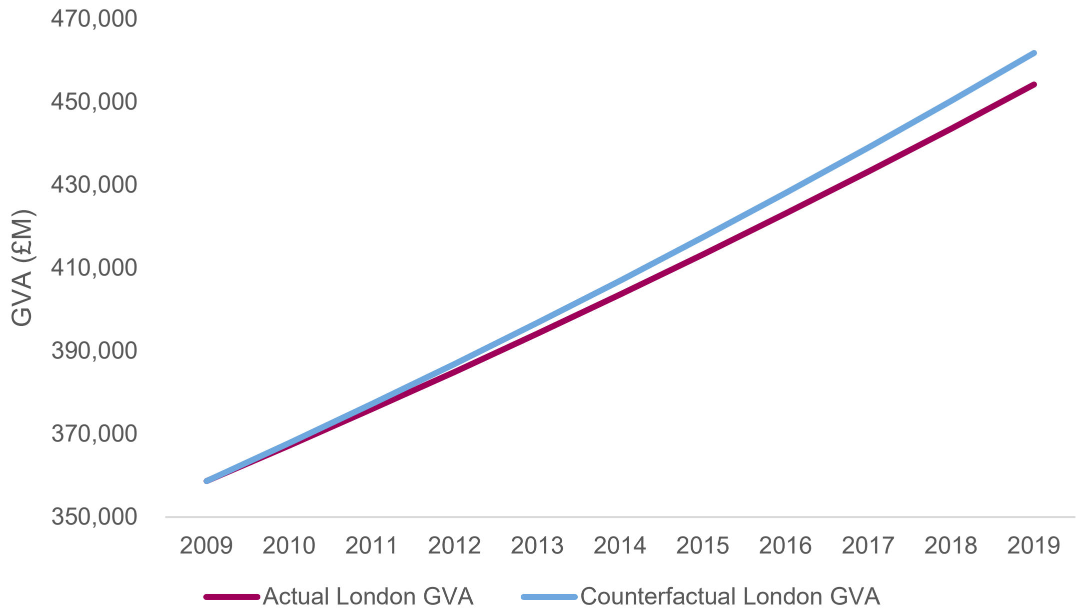
[9] **Note**: While economists tend to look at Gross National Product (GNP) instead when analysing Ireland's growth and income, data on GNP at the city level (i.e., for Dublin) could not be found. Moreover, including GNP data for Dublin (even if available) while using GDP data for the other 35 would have been problematic.

[10] Revenue Statistics 2019 | en | OECD

- The average annual real GDP growth for the 'comparator cities' between 2010 and 2019 was 2.56%, while for London it was 2.39%.

- If London had also grown by 2.56% during that decade, then the city would have generated at least an additional £38bn over the 10 years (see Figure 1). This would translate to about an extra £460 per Londoner per year.

Figure 1. London's actual GVA growth vs. counterfactual scenario (2010-2019)
Comparing London to the largest cities in OECD countries with unitary structures that devolve more revenue generation locally



Source: GLA Economics modelling based on data from ONS, OECD, Eurostat, Central Banks and Statistical Agencies (for non-EU OECD countries)

SCENARIO 2: Comparing London to the largest cities in OECD countries that devolve more revenue generation locally (all governance structures)

- For this scenario, all 23 countries that devolve more revenue generation to local government were included, and the cities with the largest GDPs in these countries were selected as the 'comparator cities'.

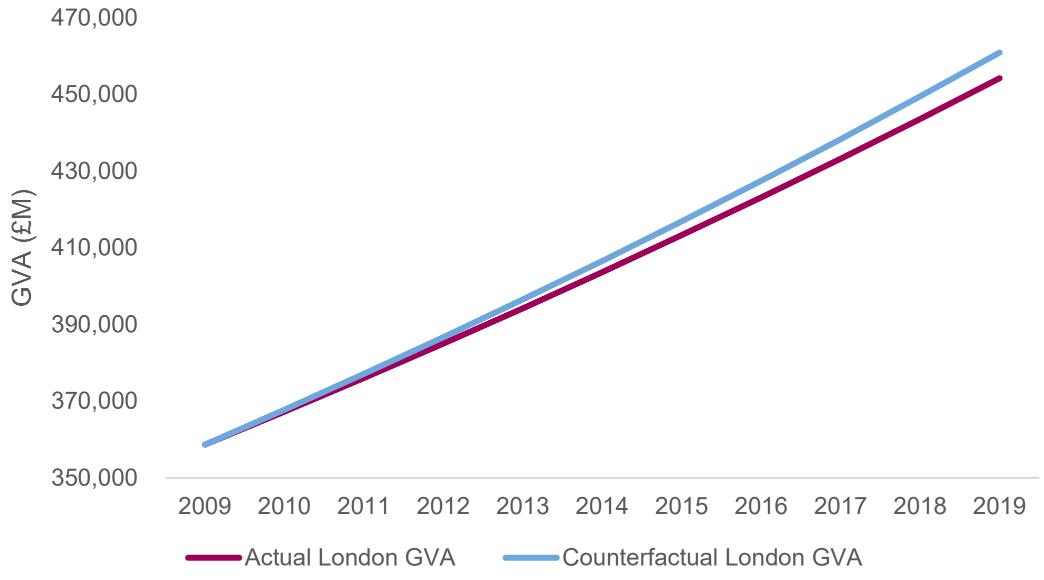
- For these cities, their GDPs (in current prices) for the years 2010-2019 were also collected from sources such as their countries' statistical agencies, their central banks, and Eurostat (for cities in EU member-states).

- These current-price GDPs were adjusted for inflation using Consumer Price Index data for the 23 countries (collected from the World Bank), before determining the average real GVA growth for each city.

- The average annual real GVA growth for the 'comparator cities' between 2010 and 2019 in this scenario was 2.54%.

- If London had also grown by 2.54% during that decade, then the city would have generated at least an additional £34bn over the 10 years (see Figure 2). This would translate to about an extra £400 per Londoner per year.

Figure 2. London's actual GVA growth vs. counterfactual scenario (2010-2019)
Comparing London to the largest cities in OECD countries that devolve more revenue generation locally (all governance structures)



Source: GLA Economics modelling based on data from ONS, OECD, Eurostat, Central Banks and Statistical Agencies (for non-EU OECD countries)

Implications

- The above scenarios would suggest that the UK's overly centralised system of revenue generation could have harmed London's growth potential.
    - It is worth noting that cities in OECD countries that devolved the same or a lower percentage of revenue generation locally as the UK have experienced lower average annual real GDP growth between 2010 and 2019 than the UK. Looking at those with unitary governance structures, they grew by 2.33%. If we look at all such cities irrespective of governance structure, the rate was 2.08%.
- By running a scenario with cities in OECD countries that only have unitary governance structures, the analysis sought to control for the impact of the political system on devolution of revenue-generating powers.
    - The cities are in countries with similar levels of economic development to the UK and have similar political structures, while delegating a greater proportion of revenue generation to their local authorities.
- It is worth noting that comparing these cities' real annual growth rates to those of their respective countries shows that higher real national growth cannot explain (in and of itself) the cities' growth rates.

  - For example, Oslo, Copenhagen, and Berlin grew faster than London in spite of their countries growing more slowly than the UK during the 2010s. However, these cities also happen to devolve a much larger share of tax-generating powers to local and regional governments.
  - There are also cases (e.g., Sydney and Budapest) where the cities grew more slowly than London in spite of higher national growth rates. These cities happen to devolve less fiscal powers than the UK.

- It is also worth noting that of all 35 OECD cities in the study, none grew faster than London, had slower national growth rates than the UK, and happened to be more fiscally centralised.
  - By the same token, none grew more slowly than London in spite of higher national growth rates and having more revenue generated locally.
- The results align with recent findings from Cebr, which show that there exists a robust and positive relationship between GDP and revenue decentralisation.
  - The results also reinforce GLA Economics' previous findings on the devolution/growth literature, which identified that devolving more tax and revenue-generating powers to the local level is likely to foster economic growth.
- London's (and the UK's) economic growth is impacted by more than just devolution of fiscal powers such as taxation.
  - Nevertheless, the data suggests that the UK's greater centralisation of such powers coincides with London's constrained growth over the past decade, at a time when comparable cities that raised more revenue locally enjoyed greater growth in real terms.
  - This would suggest a decade of significant foregone revenue not just for Londoners, but also the UK's Exchequer given that London as a region is the biggest net contributor to the Treasury.

Appendix

Table 1. OECD countries[11] included by system of governance and % of total tax revenue generated by local governments

OECD country (Largest city by GDP)	System of governance	% of revenue generated by local government
Australia (Sydney)	Federal	3.4
Austria (Vienna)	Federal	3.2
Belgium (Brussels)	Federal	5.1
Canada (Toronto)	Federal	10.2
Germany (Berlin)	Federal	8.2
Mexico (Mexico City)	Federal	1.5
Switzerland (Zurich)	Federal	15.7
United States (New York)	Federal	15.5
Colombia (Bogota)	Regional	13.3
Spain (Madrid)	Regional	8.8
Chile (Santiago)	Unitary	8.7
Czech Rep (Prague)	Unitary	1.0
Denmark (Copenhagen)	Unitary	26.9
Estonia (Tallinn)	Unitary	0.8
Finland (Helsinki)	Unitary	24.7
France (Paris)	Unitary	13.5
Greece (Athens)	Unitary	2.5
Hungary (Budapest)	Unitary	5.2
Iceland (Reykjavik)	Unitary	29.8
Italy (Rome)	Unitary	11.0
Japan (Tokyo)	Unitary	23.0
Korea (Seoul)	Unitary	19.0
Latvia (Riga)	Unitary	17.9
Lithuania (Vilnius)	Unitary	1.1
Luxembourg (Luxembourg)	Unitary	4.2
Netherlands (Amsterdam)	Unitary	3.5
New Zealand (Wellington)	Unitary	6.1
Norway (Oslo)	Unitary	16.9
Poland (Warsaw)	Unitary	12.4
Portugal (Lisbon)	Unitary	7.2
Slovak Rep (Bratislava)	Unitary	2.1
Slovenia (Ljubljana)	Unitary	9.7
Sweden (Stockholm)	Unitary	36.8
Türkiye (Istanbul)	Unitary	9.4
United Kingdom (London)	Unitary	5.6
OECD Average		10.8

Source: OECD Revenue Statistics 2019

[11] Sample excludes Ireland, Israel and Costa Rica (see page 3).

Table 2. GDP data sources by city

City	Data source
Australia (Sydney)	https://economy.id.com.au/sydney/gross-product
Austria (Vienna)	Eurostat: Statistics | Eurostat (europa.eu)
Belgium (Brussels)	Eurostat: Statistics | Eurostat (europa.eu)
Canada (Toronto)	Statistics Canada: Gross domestic product (GDP) at basic prices, by census metropolitan area (CMA) (statcan.gc.ca)
Germany (Berlin)	Eurostat: Statistics | Eurostat (europa.eu)
Mexico (Mexico City)	Mexico City government: indicadores-economicos-de-la-ciudad-de-mexico042022.pdf (cdmx.gob.mx)
Switzerland (Zurich)	Swiss Federal Statistical Office: Gross domestic product per canton and region | Federal Statistical Office (admin.ch)
United States (New York)	Bureau of Economic Analysis: GDP by County, Metro, and Other Areas | U.S. Bureau of Economic Analysis (BEA)
Colombia (Bogota)	Departamento Administrativo Nacional de Estadísticas: DANE - Cuentas nacionales departamentales: pib trimestral bogotá d.c.
Spain (Madrid)	Eurostat: Statistics | Eurostat (europa.eu)
Chile (Santiago)	Banco Central de Chile: Base de Datos Estadísticos (BDE) (bcentral.cl)
Czech Rep (Prague)	Eurostat: Statistics | Eurostat (europa.eu)
Denmark (Copenhagen)	Eurostat: Statistics | Eurostat (europa.eu)
Estonia (Tallinn)	Eurostat: Statistics | Eurostat (europa.eu)
Finland (Helsinki)	Eurostat: Statistics | Eurostat (europa.eu)
France (Paris)	Eurostat: Statistics | Eurostat (europa.eu)
Greece (Athens)	Eurostat: Statistics | Eurostat (europa.eu)
Hungary (Budapest)	Eurostat: Statistics | Eurostat (europa.eu)
Iceland (Reykjavik)	Statistics Iceland: Local government - Statistics Iceland (statice.is)
Italy (Rome)	Eurostat: Statistics | Eurostat (europa.eu)
Japan (Tokyo)	Statista: Tokyo - statistics & facts | Statista
Korea (Seoul)	Statistics Korea: KOSIS Korean Statistical Information Service
Latvia (Riga)	Eurostat: Statistics | Eurostat (europa.eu)
Lithuania (Vilnius)	Eurostat: Statistics | Eurostat (europa.eu)
Luxembourg (Luxembourg)	Eurostat: Statistics | Eurostat (europa.eu)
Netherlands (Amsterdam)	Eurostat: Statistics | Eurostat (europa.eu)
New Zealand (Wellington)	Statistics New Zealand: NZ.Stat (stats.govt.nz)
Norway (Oslo)	Eurostat: Statistics | Eurostat (europa.eu)
Poland (Warsaw)	Eurostat: Statistics | Eurostat (europa.eu)
Portugal (Lisbon)	Eurostat: Statistics | Eurostat (europa.eu)
Slovak Rep (Bratislava)	Eurostat: Statistics | Eurostat (europa.eu)
Slovenia (Ljubljana)	Eurostat: Statistics | Eurostat (europa.eu)
Sweden (Stockholm)	Eurostat: Statistics | Eurostat (europa.eu)
Türkiye (Istanbul)	Turkstat: TURKSTAT Corporate (tuik.gov.tr)
United Kingdom (London)	Office for National Statistics: Regional gross domestic product: all ITL regions - Office for National Statistics

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